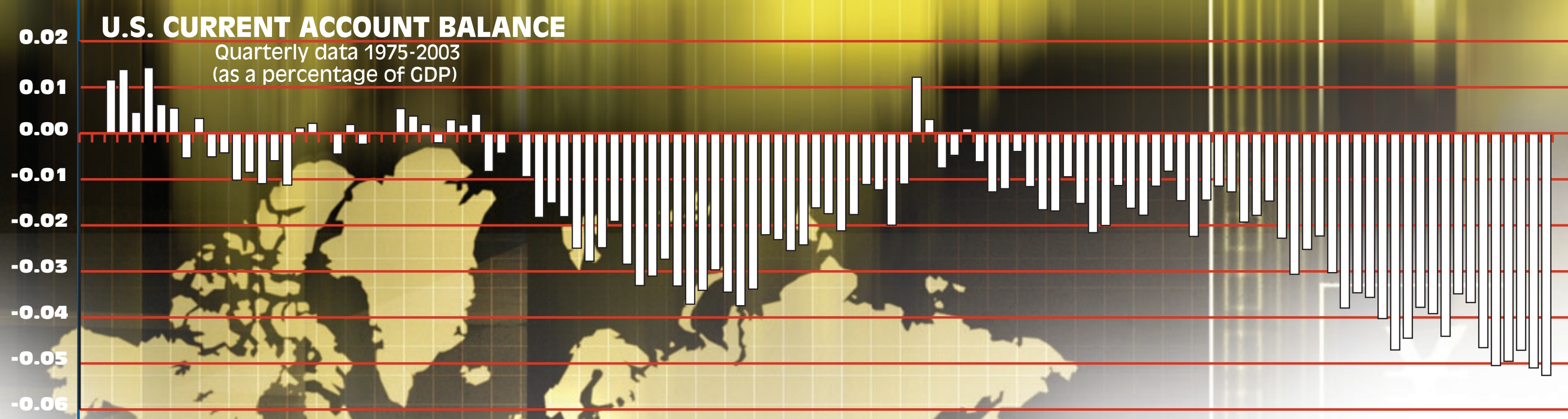

Global Economic Recovery

Gathering Momentum

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The world economy is in the second year of a gradual and uneven recovery from the downturn of 2001. There is enough information available for 2003 to estimate that world growth for the year was approximately 3.3 percent. Compared with past recoveries, the current one is slow and tenuous. At the end of 2003, most of the major economies across the globe were gathering momentum. The outlook for 2004 is that the world economic growth will accelerate to a growth rate of around 4 percent.

The table on page 23 reveals the widespread nature of the 2001 downturn and the irregular and uneven character of the recover since then. In industrial economies, economic growth fell from 3.6 percent in 2000 to 1.1 percent in 2001. The growth rate fell sharply in all industrial regions and in most of the industrial countries shown in the table with the exception of Australia. In 2002, with moderately better growth in the United States and very good growth in Canada and Australia, the record for the industrial economies improved a little, but slower growth in Europe and recession in Japan keep the overall growth rate for this group of countries well below potential. In 2003, economic growth in the United States and Japan picked up in the first half of the year, but growth in the euro area stalled. During the second half of 2003, Europe showed positive indications, and signs of stronger growth appeared in most industrial countries, most notably in the United States, where third quarter growth surged to a 20-year high.

The emerging markets of Latin America and Asia showed the most significant impact of the world recession of 2001. In the case of Asia, dependency on the United States as an export market, in particular telecommunications and computer product exports, severely undercut growth in Taiwan, Hong Kong, Singapore, the Philippines, and Malaysia. Imports to the United States of manufactures from several of these countries continued to fall in early 2002 before picking up modestly later in the year. While Asian growth fell by two percentage points in 2001, in comparison with the previous year, the expansion in Asia continued well above world averages owing to continued strong growth in China. Today, China accounts for nearly half of the output in Asia's emerging markets (excluding Japan, Australia, and New Zealand). Overall, growth in the emerging markets of Asia increased to 6.2 percent in 2002 and 6.3 percent in 2003 (estimate) and is forecast at 6.5 percent for 2004.

Latin American emerging markets were hit particularly hard by the 2001 slump. Growth slowed dramatically before falling into negative territory in 2002. Much of the slowdown was centered in the three giants of the region: Argentina, Mexico, and Brazil. These three countries account for 10 percent, 23 percent, and 32 percent, respectively, of total Latin American output. In 2002 the 0.5-percent decline in Latin American output was centered in Argentina, where output fell by nearly 11 percent following the financial crisis of December 2001.

In 2003, Argentina's economy began a strong rebound, but the economies of Mexico and Brazil were very sluggish while political turmoil in Venezuela resulted in a sharp 10-percent decline in output. The net result has been a third consecutive year of very poor growth in Latin America, but—excluding the continuing political uncertainty in Venezuela and several Andean countries—indications are that growth in the region will rebound to nearly 4 percent in 2004.

Among the major groups of emerging market economies, only the transition economies of Central-Eastern Europe and the former Soviet Union enjoyed continued good growth through 2001 and 2002, even though growth was less than the excellent 7-percent growth recorded in 2000. When the final data for 2003 is tallied, this group of countries is expected to have achieved another solid year of growth around 5 percent. Within this group of economies, Russia and Poland are the giants, accounting for approximately 43 percent and 13 percent, respectively, of total output in the region. Very strong growth in Russia, supported by higher energy prices, large export surpluses, and increasing consumer demand helped to offset a third consecutive subpar year of growth in Poland. In 2004, solid economic performance is expected with around 5 percent.

On balance, the condition of the world economy looks as stable and favorable as it has in several years with one important concern—the U.S. economy is again leading the world recovery. Why is this a problem? The key issue relates to the U.S. current account deficit. Many observers believe that the U.S. current account constitutes an important imbalance in the global economy. Although there is evidence that a deficit of 4 to 5 percent of GDP is sustainable for a considerable period of time, these observers worry that the rapid growth of the U.S. current account deficit cannot continue indefinitely.

Unfortunately, the short, shallow 2001 U.S. recession did not lead to a sustained correction in the U.S. current account. Although it fell from 4.7 percent of GDP in the third quarter of 2000 to 3.6 percent of GDP during the third quarter of the recession year of 2001, the currentaccount deficit began to grow again as the economy recovered. The deficit reached an estimated 5.3 percent of GDP in the third quarter of 2003. With most forecasts stating that the U.S. economy will grow by 3 to 4 percent in 2004, there is little doubt but that the U.S. current account deficit will continue to grow in the coming year. This is a symptom of the world's continued overdependence on U.S. growth in the past few years.

Despite these concerns, there are several positive factors at work in the world economy that make the current outlook more hopeful than it has been in many months. First, geopolitical tensions have been reduced compared with the period before and just after the Afghanistan and Iraq invasions. The reduction in international tensions has been reflected in generally higher business and consumer confidence throughout the world.

A second major factor is that the current recovery is taking place during a period of low price inflation. Indeed, there were concerns just a few months ago that world price deflation was a threat. While deflation remains a problem in a few areas, primarily in Japan and in the Chinese manufacturing sector, the general threat of deflation has passed. Instead, there has been a gradual recovery in the prices of many commodities, a trend that has benefited those economies, primarily emerging markets that depend on commodity exports for significant foreign exchange earnings. Most commodity price indices are well above their levels of two years ago, and the terms of trade of producing countries have improved.

Emerging market economies have benefited of late not only from improved terms of trade but also through sharply lower risk premiums on borrowed funds. With no major financial crises in nearly two years and investment returns generally low in the more developed economies, foreign investors have been more willing to extend funding to emerging markets at reduced rates. The easier credit terms, in turn, have allowed emerging market governments to balance fiscal budgets.

In general, there has been marked improvement in most areas within emerging markets as a result of better fiscal discipline, more transparency in economic institutions, better monetary policy, and increased intraregional trade in emerging market areas, particularly in Asia and Central-Eastern Europe.

Some potentially troublesome issues could threaten the stability of the current recovery, aside from the inherent risks in yet another U.S.-led world recovery discussed above. Foremost among these concerns is the threat of renewed terrorist attacks. This danger not only contributes to an environment of uncertainty, but perhaps more importantly, protection against this danger drains scarce resources from more productive uses. Another big danger is the long-run fiscal stance of many developed countries. Countries with rapidly aging populations and inadequately funded social retirement systems especially are at risk. Finally, the suspension of the Doha round of WTO negotiations at Cancun last September was a setback to progress in trade liberalization, and it may be a sign of greater threats of trade protectionism. ■

REGIONAL ANALYSIS

In 2002, more than 90 percent of U.S. exports of manufactured goods were shipped to three world regions—the United States' North American Free Trade Agreement (NAFTA) partners (38 percent), Asia, including Australia and New Zealand (29 percent), and Europe (25 percent). Exports to South America accounted for another 7 percent, bringing the total share for countries in these four regions to more than 99 percent of total U.S. manufactured exports. Within these broad groupings, U.S. exports to 10 countries—Canada, Mexico, four countries in Western Europe, and four countries in Asia—equaled more than two-thirds of all U.S. exports of manufactured goods.

The economic outlook within these three regions, and the 10 countries in particular, strongly influences the prospects for U.S. exports in a given period. In addition, the value of the dollar relative to the currencies of these countries is a major factor determining the competitiveness of U.S. exports in these markets compared with local products and compared with products from other countries. The following is a brief synopsis of current conditions within these important export markets and the prospects for economic growth over the next year.

NAFTA

Canada and Mexico are the most important trading partners of the United States. The United States ships more than one-third of its manufactured goods to the two countries and receives nearly 30 percent of its total manufactured goods imports from the two countries. U.S. manufactured goods exports to both countries dropped in 2001 and in 2002, but recovered somewhat in 2003. The fall in exports to the United States' NAFTA partners was part of an overall decline in U.S. manufactured goods exports in 2001 and 2002 and part of the global decline in world trade.

In 2002, Canada was one of the better performing developed industrial economies. Although growth slowed to 1.5 percent in 2001, Canada avoided the recession that hit the United States. In 2002, the economy accelerated and recorded a 3.3-percent rate of growth, the best showing among the Group of Seven. Early in 2003, the Canadian economy began to slow. The sluggish recovery in the United States, coupled with a sharp appreciation of the Canadian dollar began to a their toll on Canadian exports. Additionally, Canada was hit by a series of economic shocks in early 2003 that dampened growth. These shocks included an outbreak of severe acute respiratory syndrome (SARS) in the Toronto area and the discovery of a case of mad-cow disease that resulted in an embargo on Canadian beef shipments. The Northeast power blackout and Pacific Northwest forest fires also adversely affected Canada's economy. In reaction to deteriorating economic conditions, the Bank of Canada cut interest rates last summer. Aside from strong consumer spending, much of the economy remained tepid at the end of 2003. The strong Canadian dollar has brought inflation down, and interest rates may be cut again if growth rates do not meet projections. The Canadian economy is expected to grow areoun 3 percent in 2004.

Mexico, after Canada, is the United States' second most important trading partner.

Mexico is the second-largest export market for U.S. manufactured goods and is the fourth-largest source of manufactured goods imports into the United States. In 2001, Mexico was the third-largest source of manufactured goods for the United States, just behind Japan, but rapidly rising U.S. imports from China have pushed China into second place ahead of both Japan and Mexico.

Mexico's economy began recovering from the 2001 recession in the spring of 2002, but growth remained sluggish throughout 2002 and 2003. Mexico's economy is highly dependent on the U.S. economy, particularly the U.S. manufacturing sector. Since manufacturing in the U.S. has been slow to recover, Mexico's economy has also failed to show much growth. Aside from the slow rebound in exports to the U.S., Mexico has experienced the loss of tens of thousands of jobs in its manufacturing sector as jobs and plants have migrated to China and Central America, where wages are much lower.

Slow export growth and uncertainty about the pace of Mexican reforms in tax policy and in the electrical energy industry have been factors behind the eroding value of the peso. Higher oil revenues and growing remittances by Mexicans working in the United States have largely offset weak exports and foreign investment flows. Remittances amount to nearly $15 billion, making these payments the second leading source of foreign exchange after oil shipments. Despite the lower value of the peso, inflation and interest rates have remained low. The continued healthy expansion of the U.S. economy is expected to be the primary force behind an anticipated acceleration of Mexican growth in 2004 when GDP is expected to grow by around 3.5 percent. ■

World, Regional & Country Growth

	1999	2000	2001	2002	2003	2004
WORLD	3.7	4.8	2.4	2.8	3.3	4.1
INDUSTRIAL ECONOMIES	3.3	3.6	1.1	1.5	1.9	3.0
UNITED STATES	4.5	3.7	0.5	2.2	2.9	4.2
CANADA	5.5	5.3	1.9	3.3	1.9	3.0
JAPAN	0.1	2.8	0.4	-0.4	2.4	1.8
EC- 15	2.8	3.7	1.8	1.1	0.8	2.0
UNITED KINGDOM	2.8	3.8	2.1	1.7	2.0	2.7
EURO AREA	2.8	3.7	1.7	0.9	0.5	1.8
GERMANY	1.9	3.1	1.0	0.2	0.0	1.6
FRANCE	3.2	4.2	2.1	1.3	0.2	1.8
ITALY	1.7	3.3	1.7	0.4	0.4	1.6
AUSTRALIA	4.4	3.0	2.7	3.3	2.4	3.7
EMERGING MARKETS	4.2	5.9	3.7	4.4	4.9	5.5
AFRICA	2.7	2.9	3.5	3.2	3.6	4.6
SUB-SAHARA AFRICA	2.8	3.0	3.5	3.2	3.5	4.8
ASIA	6.4	7.0	5.1	6.2	6.3	6.5
CHINA	7.1	8.0	7.5	8.0	8.2	7.7
INDIA	0.0	0.0	0.0	0.0	0.0	0.0
NICS	0.0	0.0	0.0	0.0	0.0	0.0
KOREA	-0.0	-0.0	-0.0	-0.0	-0.0	-0.0
ASEAN	0.1	0.1	0.1	0.1	0.1	0.1
INDONESIA	0.1	0.1	0.1	0.1	0.1	0.1
MIDDLE EAST	-0.0	-0.0	-0.0	-0.0	-0.0	-0.0
CENT & S. AMERICA	0.1	0.1	0.1	0.1	0.1	0.1
BRAZIL	0.1	0.1	0.1	0.1	0.1	0.1
MEXICO	0.1	0.1	0.1	0.1	0.1	0.1
INDIA	6.7	5.4	4.2	4.7	6.1	6.3
NIES	7.9	8.4	0.8	4.7	2.5	4.8
SOUTH KOREA	10.9	9.3	3.1	6.3	2.5	4.8
ASEAN	3.5	5.7	2.9	4.4	4.3	4.7
INDONESIA	0.8	4.9	3.4	3.7	3.7	4.3
MIDDLE EAST	0.8	5.6	0.5	4.1	4.5	4.3
LATIN AMERICA	0.2	4.0	0.6	-0.5	1.3	3.7
BRAZIL	0.8	4.4	1.4	1.5	0.7	3.2
MEXICO	3.7	6.6	-0.2	0.7	1.6	3.5
TRANSITION ECONOMIES	4.0	7.1	5.1	4.0	5.1	4.8
East & Central Europe	2.2	3.9	3.0	2.9	3.6	4.3
POLAND	4.1	4.0	1.0	1.4	3.3	4.5
CIS - TOTAL	5.2	9.1	6.3	4.7	6.0	5.0
RUSSIA	6.3	10.0	5.0	4.3	6.3	5.1
UKRAINE	-0.2	5.9	9.2	4.8	5.0	4.5
TOP 20 U.S. MARKETS FOR MANUFACTURED GOODS	3.8	5.2	2.8	3.0	3.1	3.8

SOURCE: Historic data are from the IMF;
forecast data from the U.S. Department of Commerce, ITA.

GLOBAL OUTLOOK

ASIA

U.S. exports to Asian countries fell almost across the board in 2001 and 2002. In the first 10 months of 2003, U.S. exports to Pacific Rim countries were up only 3.2 percent compared with the same period in 2002, and most of this increase was related to a 22-percent increase in shipments to China.

Despite the sluggish growth of U.S. exports to Asia in 2003, the region as a whole did well, as it did in 2002. Even Japan's economy, which fell in 2002 after growing only marginally in 2001, grew by more than 2 percent in 2003. There are two main reasons for the recent success of Asia's economy despite sluggish growth in much of the world. China has emerged as a center of economic activity in the region. A significant share of the recent growth in the economies of Southeast and North Asia can be attributed to the growth of China's imports from the region. For example, through the first 10 months of 2003, China's imports from its leading trading partners in Asia increased as follows: from Japan, up 39 percent; from Taiwan, up 29 percent; from South Korea, up 53 percent; from Malaysia, up 53 percent. While attention has focused on the growing deficit in U.S. trade with China, China's trade surplus with the world decreased sharply in 2003, falling 40 percent between January and October, compared with the same period in 2002.

A second element behind Asia's resilience is the growing importance of domestic consumption as a source of growth in Asia. South Korea, China, Thailand, and Malaysia are countries where domestic demand has made an important contribution to growth.

The outlook for Asia in 2004 makes the region important to world growth. Japan's economy is expected to grow moderately, but continuing problems with deflation, financial sector weaknesses, slow industrial restructuring, and a stronger yen are important downside risks. China's economy expanded more rapidly than expected in 2003, despite the impact of the SARS epidemic in the second quarter. During the second quarter of 2003, China's central bank began to rein in the rapid increase in credit, which, together with large inflows of foreign investment, was spurring large increases in domestic investment. In September, the central bank increased the reserve requirement on lending institutions to further slow the expansion of credit. These steps are expected to trim GDP growth to less than 8 percent in 2004.

India, the other giant among the emerging markets of Asia, has also experienced strong growth in recent years. Foreign investment, though not as strong as in China, has been growing, particularly in the information technology sector. Currently, India is not a leading trading partner of the United States, and the country ranks only 11th among U.S. trading partners in Asia. India's economy has been growing rapidly, however, and some predict that its growth could soon outpace that in China. In 2003, India's economy grew more than 6 percent, according to many estimates, and similar growth is expected in 2004.

Growth in South Korea, Hong Kong, Singapore, and Taiwan was poor in 2003. Even South Korea, which enjoyed strong growth in 2002, fell into a slump during the first half of 2003. SARS played a depressing role in the economic performance of all the countries, but Hong Kong and Singapore, with their large reliance on tourism, suffered the most. These countries all suffered following the 2001 bust in the world telecommunications sector. The continuing shift of manufacturing operations from these countries to mainland China has compounded their problems. All four of these East Asian countries were among the top 10 export destinations for U.S. manufactured goods just two years ago, but Singapore and Hong Kong have fallen to 11th and 15th, respectively. Expansionary fiscal policies, stronger domestic consumption, and increased regional trade are expected to boost growth to nearly 5 percent in 2004. The economies of the 10 members of the Association of Southeast Asian Nations grew collectively at about the same rate in 2003 as in 2002 (approximately 4.5 percent).

The other major industrial economies in the Pacific Rim, Australia and New Zealand, grew 3 percent and 2.6 percent, respectively, in 2003. Australia's economy was hit by severe drought in 2002, seriously damaging the agricultural sector. The Australian dollar is another currency that has been appreciating against the dollar after several low-value years. Unemployment has been falling and consumption is strong. The outlook in 2004 is that Australia's economic growth will pick up slightly to around 3.5 percent, while New Zealand's economy expands at a rate of nearly 3 percent. ■

EUROPE

Photo courtesy of European Commission Audiovisual Library.

With an economy nearly the same size as the U.S. economy, but a population approximately 30-percent larger, the European Union is poised to welcome 10 new members in 2004. Collectively, the accession countries will boost the EU population an additional 20 percent (currently at 380 million). However, the increase in total output represented by the 10 new members is only 5 percent of current EU production, due to much lower productivity in the economies of the acceding members. Perhaps more importantly for the longer term, the new members will expand the geographic territory of the European Union well into Central Europe and increase its border with the Commonwealth of Independent States, making the European Union a true pan-European economic bloc.

As part of the integration process, the new members have modified their laws to conform to the standards of the EU and have taken steps to bring their fiscal and monetary policies in line with EU guidelines.

Only eight of the current EU countries are among the top 20 markets for U.S. manufactured goods, and none of the new members are in this group. The three new members that are the largest current markets for U.S. exports are Poland, Hungary, and the Czech Republic. Exports of U.S. manufactured goods to these three markets were less than $2 billion in 2002, which accounts for less than 1 percent of total U.S. manufactured exports. What is more important, however, is that these new members are rapidly becoming more integrated with Western Europe's economies through trade and investment. Companies located in the current European Union, including many American firms, have invested in these economies, and production is being integrated across the continent.

Currently, the United States ships nearly 25 percent of its manufactured goods to Europe. In the last two years, U.S. manufactured goods exported to Europe declined at about the same rate as exports to the rest of the world. The outlook for exports in the next year is somewhat more hopeful in that there are signs that growth in Western Europe turned up in the second half of 2003. Business confidence has improved a bit, but consumer confidence still lags and unemployment is high. Among the new members growth has been much better, and the outlook for 2004 is better as well. Central Europe, which includes five new members (Poland, Hungary, Slovenia, the Czech Republic, and Slovakia) had economic growth of 3 percent in 2003 and is projected to grow at about 4 percent in 2004, largely because of an increase in GDP growth in Poland, by far the largest economy among the new members. Growth in the Baltic States of Latvia, Estonia, and Lithuania has also been positive, 6 percent in 2003 and approximately the same is expected in 2004. ■